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# **NATIONAL BUDGET 2009**

## **SOCIAL IMPACT OF RISING PRICES – MITIGATING MEASURES FOR THE LOWER INCOME GROUP**

**BY**



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**30<sup>TH</sup> MARCH 2008**

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## MEMORANDUM ON CONSUMER PRICES

FOMCA has been carrying out research and its own price surveillance in various cities and towns across the country and the finding indicate that the prices of daily products, mainly food items have been steadily increasing. Escalating oil prices has led to the price increase in almost all goods due to the increase in oil prices and toll hikes. FOMCA believes that there are also other dominating factors which play a significant role in the price hike of daily consumables.

FOMCA identifies the contributing factors as follows:

### **1. High Food Import Bill**

In the year 2005, the country's food import bill was recorded at RM17.793 billion while the food export bill only amounted to RM10.674 billion, translating into a deficit of RM7.119 billion in the Balance of Trade in Food Stuff (BOTFS). For more than a decade, Malaysia has been relying heavily on imports for the growing food demand. Countries such as United States, Australia and New Zealand, China, Thailand and Indonesia dominate the food market share of the country (Grain Report, 2003). We import dairy products from New Zealand while vegetables and fruits products mainly originate from Australia and United States. Malaysia is a net importer of seafood products (i.e. fish and other related seafood items) mainly from Thailand and Indonesia. The inability to sustain our food production to cater for national demand continues to inflate the food import bill has led to the increase in food prices.

The Statistics Department has reported that in 2005, Malaysia imported;

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|---|------------------|
| <b>Food Crops –</b>                                     | RM11.154 billion |
| <b>Livestocks –</b>                                     | RM2.934 billion  |
| <b>Fisheries –</b>                                      | RM1.902 billion  |
| <b>Miscellaneous edible products and preparations –</b> | RM1.802 billion  |

## **2. Surging Energy Demand – Development of Biofuels**

The worldwide biofuel boom is only at its beginning and yet it has already pushed up the cost of staples around the world. In Mexico, rocketing tortilla prices have caused severe socio-economic repercussions and sparked angry protests. As Malaysia is striving to make headways in developing biofuel from planting of cash crops such as oil palm, the growing hype and drive towards the cultivation of crops for biomass fuel should proceed with extreme caution. New agricultural developments such as the Northern Corridor Economic Region (NCER) must take into account the need to have a sustainable food production as its primary objective, and the government must ensure that land for food crops are not sacrificed in favor of biofuel crops, which will inflate food prices and also further drive up our food import bill.

## **3. Climate Change**

Erratic weather patterns in recent times have resulted in increased rainfall, more storms and even severe floods. The tropical climate in Malaysia has resulted in constant fluctuations in temperature within the range of 25.4°C to 34.6°C. Disrupted crop cycles and marine harvests have inevitably led to higher cost of production. It is becoming more difficult for farmers to grow local vegetables and fruits, and heavy rainfalls can deny them of a good harvest. Under such circumstances, farmers are forced to raise their selling price to support their livelihood.

## **4. Shortages of Labor**

One of the main reasons for increases in prices of essential items such as food is the shortage of labor to operate the industry. The drastic fluctuation of food prices in recent years is partly due to the government's decision to evict foreign workers back to their own country. The agricultural industry relies heavily on the foreign workforce. Locals are reluctant to take on hard labor or work in the agriculture sector, as they perceive it to be harsh and unrewarding. The sudden vacuum of manpower has forced farmers to hire expensive local workforce and hence, the higher overhead cost is passed on to consumers.

## **5. Global Trade**

Globalisation has changed the way businesses are conducted today. The volume of world food trade is enormous and there is a significant increase in both the quantity and variety of food moving in international trade. Malaysia, as a signatory to the WTO is bound by several international trade agreements. Under the General Agreement in Trade and Services (GATS), Malaysia is legally bound to gradually reduce its protection over the domestic market. GATS aims to promote international trade in services and removing barriers to trade by encouraging privatization. Previous experiences have proven that privatization occurs in parallel to the increase in prices. This is of greater concern when basic public sector entities such as water and healthcare are gradually being privatized.

## **6. Rising Prices of Essential Goods and Services**

The price hikes of essential goods and services over the period of last 2 years have been a major concern for consumers. The middle and lower income groups have been bearing the brunt of price onslaught and many are feeling insecure over future conditions and highly concerned on how to sustain their families and livelihood.

### Fuel

As consumers are gradually reeling in and adjusting to the 30 sen fuel hike in 2006, of recent anxiety is abound with the global oil price hovering between \$ 90 and \$100 USD per barrel, and many are bracing for a national fuel price increase in the near future. The fuel hike would act as a primary catalyst for inflation, spawning further increases of daily essentials.

The socio-economic repercussions are severe, as witnessed and experienced before. Profiteering is rampant, as unscrupulous traders are exploiting consumers. Traders and corporate bodies are using this as a golden excuse to raise the prices of their products and services. Those who are not willing to share the burden of the increased cost will pass the extra cost to others, be it suppliers or retailers and eventually to consumers. Many sectors of the industry are taking advantage of the situation by raising prices on every product and service. Public transport companies are calling for an increase in fares. Price of

electricity has gone up, water tariffs have risen, highway toll hikes are dramatic, and food prices are fluctuating in an upward trend.

### Public Transport

Inefficiency in the public transport system has inadvertently heightened the demand for fuel. Fares are rising and consumers are overly burdened. Most operators are independent companies, instead of collaborating and planning to optimize their services, it is their business nature to compete among each other. This has resulted in railways, LRTs, monorail, stage buses, and taxis lacking a coordinated network of efficient public transportation system. Public transport operators have been making demands for increasing fares. Taxis charge expensive fares nowadays that riding it can almost be considered a luxury. Coupled with the rampant numbers of errant operators charging unscrupulously, consumers are left far in the losing end. It was reported that many stage bus operators had allegedly marked up their fares above the quantum fixed by the government. The recent strike of the RapidPenang workers is a snapshot of a likely future scenario, should the issue of fares and wages are not addressed to.

### Healthcare

The healthcare system has been financed by the government through tax revenue since independence. However, faced with globalisation and trade liberalisation and the need to reduce its internal financial burden, the Malaysian government has gradually been giving up its universal model of a healthcare system and giving way to privatisation of medical services. Healthcare expenses are exponentially rising and increasingly public hospitals are establishing private wings and pharmacies for consumers who can afford to pay for better services. At the outset, the idea seems novel and attractive to those working in the public sector. However, there are serious implications for consumers especially the lower income group and self-employed. There is also the possibility of discrimination, which might pit one set of professionals against another for the sake of money. A look at our private health sector and how it operates and motivated solely by profit should be able to give us an insight into the repercussions of the move to encourage privatisation in parts of the public health sector.

While the rich in Malaysia may seek healthcare services at luxury private hospitals, the poor have to wait in long queues at the government hospitals. In the long run, deregulation and privatisation will not just enlarge the quality gap of healthcare services between the rich and poor, but it will also jeopardise the quality of public hospitals. This can be seen from the outflow of medical staff from government hospital to private hospitals and their migration from remote rural areas to urban areas as a result of lucrative offers by urban private hospitals. The proposed National Healthcare Financing Scheme is formulated to alleviate the government's subsidy on public healthcare, and it is in the form of a collection mechanism for contributions. As the exact mechanism is yet to be revealed, speculation arises on the efficiency and efficacy of the scheme and FOMCA hopes that the government will be transparent on this issue and the establishment of the scheme will indeed assuage the burden of consumers in healthcare expenses.

### Postal

Postal rates have risen due to automation of operations and reclassification. The privatisation of postal services has also resulted in the increase of postal rates to conform to international rates. Pos Malaysia Berhad posted a revenue of RM821.8 million for the year ended 2006 – a growth of RM34.8 million over the previous year. A sum of RM200 million will be spent over the next few years for new postal machinery - instead of Pos Malaysia adapting to our present conditions, we are required to adapt to the postal machinery and the higher postal rates will ensure that we pay for such modernisation.

While the postal authorities have tried to pacify consumer protest by not increasing ordinary postal rates, consumers are equally affected by the new rates as businesses pass on the increases to consumers. As things stand, the government appears to be approving tariff hikes without consulting the public; it seems to be representing the interests of privatised monopolies and not those of the public at large.

## **7. Profiteering**

Whenever the prices of any major commodity rises (fuel, toll, electricity, water, etc), the imminent aftermath will be a price hike in all consumer goods and services. Though some rises are justified as a result of direct impact (such as transportation due to fuel hike), most price rises are mere profiteering by traders. Such activities are most severe in the lower trade market such as common food traders and food services. Such unscrupulous traders are taking the opportunity to raise prices to their liking. Such blatant unethical trading is one of the major problems impacting our socio-economy and is impeding to our progress. The crucial role the middlemen play in the food chain cannot be ruled out as they determine the price and supply of food products that are available on the market shelves today. They are always in a favorable and profitable position, as they tend to generate a large profit margin from both parties, i.e. the producers and the consumers. Some act as cartels and buy at a low price from the farmers and sell those exact same produce/products at an exorbitant price to end users. They claim that handling and marketing costs contribute significantly to the price increase of these food items.

## **8. Expansion of the Middle-Income Group**

Middle income consumers have brought upon a new dimension in purchasing food items. They spend numerous hours shopping for their groceries at supermarkets and hypermarkets, as these large retailers offer a wide range of sophisticated food products. Proper storage, packaging and distribution of food items are stressed in these stores. The concept of “see, feel and pick” is practiced, whereby consumers have the liberty to touch and choose perishable food items before purchasing them. The additional charges unavoidably contribute to the price increase of food products.

## **9. Change in Modern Day Consumption Pattern**

WTO also makes an impact on consumer consumption pattern. Implications from GATS have also made the market more aggressive and competitive. As more foreign goods are making their way into the Malaysian market at very competitive prices, modern-day consumers are spurred to spend. Consumers today tend to overspend, and the large middle class society is splashing their money lavishly on new technologies, packaged

goods, and personal accessories in the name of fashion and convenience. The rampant promotion of credit cards, home loans, and hire purchase loans by financial institutions have worsened the situation. With attractive offers ranging from free gifts to low interests and easy payment schemes, the financial sector is heavily encouraging consumers to a life of credit and dragging them into life-long debts. The drastic repercussion of an overactive consumer market is the rising of prices of various goods and services due to higher demands.

### **10. Credit Culture**

The credit culture that is fast creeping in our society is becoming a major cause for concern. Young working adults immediately succumb to a live of debt with car loans, house loans, and credit card bills. The lifestyle of ‘own-now, pay-later’ is driving people into debt traps and bankruptcy. The business practices of banks charging high interests and various other exorbitant fees; they are akin to loan sharks, albeit legitimate. While the cost of living is rising alarmingly, most banks are heavily promoting its loans and credit cards. Due to the lack of (or almost non-existing) advertising laws to govern them, many marketing sleight-of-hands are being used by banks such as sending cash advances disguised as mock checks, pre-approving credit cards without consumers expressed request, luring consumers through petty reward schemes such as ‘cash back’ which refunds card holders a mere 3% if they rolled over their balances and accumulate over a certain amount. Other gimmicks such as annual waivers, contests, free gifts, and aggressive face-to-face pressure marketing are increasingly enticing vulnerable consumers to sign up for more. Unwarily, consumers are piling up their debts to the point that some people have to resort to taking up personal loans just to clear up their credit card debts. Hire purchase loans promotions are also getting out of hand as for people now can virtually own a car with very minimal or even without any down payments. Banks would drag their loans up to 9 years, which after the car owner has finished financing, one would’ve paid at least 50% more for a ten-year old car.

### **Recommendations to sustain stability of prices of essential items in Malaysia**

FOMCA realizes that to ensure the future sustainability and stability of prices of consumer goods and services of our country, a holistic approach must be adopted. Various important roles must be played not only by the government, but also by all parties to collectively unite our ideals for a sustainable future.

#### **The Government**

- **Establish a Price Commission** – Given the importance of stabilizing the cost of living and ensuring the livelihood of the rakyat, the government must place emphasis in establishing a Price Commission to holistically address consumer prices in the country. With the backing of the law, the Price Commission would have ample power to administer its functions effectively. The aims of the Commission are to oversee, monitor, and regulate prices of essential goods and services. The Commission can be formed under existing laws such as Price Control Act, Control of Supplies Act, or Consumer Protection Act, or under a new Act such as a Fair Trade Practices Act or Price Commission Act.

#### **Overall functions**

- The Commission shall be an independent economic regulator for Malaysia which oversee, monitor and regulate prices of essential goods and services in Malaysia. It shall have the power to intervene in the pricing regulation of industry regulators and government bodies in various ministries.
- The commission shall promote economic efficiency and consumer welfare in the Malaysian economy by regulating anti-competitive practices and abuse of market dominance.

- Advise the government or its agencies on issues such as pricing, efficiency, industry structure and competition.
  
- Assist other industry regulators and government bodies.

The Price Commissions functions in relation to essential services such as water, electricity, communications, transportation and postal services mean that, for these industries, it provides an integrated system of economic and license regulation in Malaysia that covers both pricing and standards of service. The existing price regulation mechanism for essential goods will be reviewed and synergized into the Price Commission.

- **Revise the Consumer Price Index** – The national CPI measures the changes in the general level of prices of a fixed basket of goods and services which represents the items which are normally consumed by an average household in Malaysia with reference to the base period. The current series of the CPI is based on the prices of 430 representative items which reflect the combined price movements each month of the thousands of items that are bought by households in Malaysia.

FOMCA suggests that it is time to review the 430 items in the CPI basket. Unnecessary and obsolete items in the basket with virtually zero weights should be critically reviewed for omission to make way for new items which will better reflect the expenditure pattern of modern day consumers. The base year for CPI reviews should also be extended from 5 years to 10 years or more to better reflect the actual inflation rate of the country to consumers. A five year base period is too short to give an accurate measure of inflation since every five years the CPI starts at zero. This is not entirely correct because prices keep on increasing continuously. There should be a continuous measure of inflation with no cut off periods which will indicate the true increase in retail prices.

The Malaysian CPI consists of only one main household class which covers both urban and rural consumers. However, as the population demographics has evolved to the point that we now have a very thick layer of middle-income earners, FOMCA suggests that the CPI to be broken into two population groups to better reflect the composition of modern day society. One group will consist of lower income earners with low consumption expenditure such as rural households and the urban poor, while the other group will consist of middle and higher income urbanites with higher consumption expenditure to better represent the national index for population. In some countries two separate CPI's are compiled to reflect the consumption patterns of urban and rural households are calculated. Policies specifying urban and rural areas will benefit from separate prices indices.

- **More allocation for social economy** – Place importance in social economy by allocating more funds to stabilise the sector. Funds can be channeled through the various reductions in other ministries such as cutting military spending and reducing unnecessary pump priming such as the recent RM70 million to be spent on boosting tobacco production under Phase 2 of the Tobacco Industry Plan. Such detrimental and unnecessary plans should be discontinued and the money should be utilised towards social welfare. Workers in the tobacco industry should be encouraged by the government to channel their agricultural expertise in the cultivation of other various types of crops and commodities.
  
- **Development of idle land** – The government to convert the eight hundred thousand to one million hectare of idle land to agricultural land. By carrying out agricultural activities on these lands, the food production of this country will increase and thus we do not need to be heavily dependent on imported food. Currently Malaysia has about 200 golf courses and lands that have been converted to golf courses amounted to 13,090 hectares with Johor having the most golf courses in Malaysia (17 courses). In line with this, the government should also reintroduce the “Rancangan Buku Hijau” campaign that was initiated by our late

Prime Minister, Tun Abdul Razak. This is to encourage the public to carry out backyard farming, hydroponic planting and organic farming. FOMCA wishes the government to take one step further in this campaign by promoting the usage of ICT tools and latest farming methods in the agriculture sector. These tools and methods can be carried out *via* Precision Agriculture (PA), one of the most scientific and modern approaches to production agriculture in the 21<sup>st</sup> century. PA promises to revolutionise farm management as it offers a myriad of potential benefits in profitability, productivity, sustainability, crop quality and environmental protection on farm quality of life, food safety, and rural economic development

- **Reduce government subsidies** - The huge RM40 billion spent by the government on subsidies alone to control prices is an unsustainable approach to artificially keep prices down. Subsidies have been known to encourage black market activities, smuggling, price distortions, and hence, inefficient allocation of resources. Fuel subsidies make up some 50% of the country's total subsidy bill, and with the spiraling global oil price, it alone will siphon off a sizable portion of the government's expenditure. The government should critically consider a gradual deregulation/removal of subsidies to avoid a negative shock to our social economy. Fuel subsidies should be gradually reduced and the government must provide a safety net for consumers especially the poor by ensuring that prices of essential consumer goods and services will not increase dramatically. The money saved from fuel subsidies can be channeled through direct social aids to improve the social sector and overall quality of living.
  
- **Revise privatized concessions of public utilities** – The increasing trend of privatizing public utilities such as water in various states has brought to an increase in consumer cost of living. Consumers are burdened with higher and higher expenses due to privatization and this has turned into a vicious cycle. The government must revise the concession terms and make it public so that the public is not burdened and informed of what they are actually paying for.

- **Enforcement of law to curb profiteering** – Focus on enforcement of law as a deterrent for profiteering. Since the soft approach of advising and educating fails to resolve the problem, the only way is the hard approach through harsher law penalties. A systematic complaint network must be set up to allow consumers to report on profiteering. Enforcement must also be widespread to rural areas, not merely in main towns and cities.
- **Develop policies that move the country towards sustainable consumption and development** – The government must move the country’s aspiration and vision towards sustainable development. The government must shift its focus in developing and implementing policies on sustainable consumption and development
- **Strive towards technology reform** – Source out alternative sustainable, renewable and green technologies. One of the main reasons for price hikes is due to depletion of resources, as it triggers higher demand and market speculation. Prices will escalate due to market changes and fluctuations. Collaborate, learn and share technological expertise with experts around the world. Development of green and sustainable technology is vital. Consumers today have comfortably accommodated themselves with modern technologies, so technology must be optimally utilised for the benefit and sustainability of mankind
- **Encourage sustainable agricultural production and national food security policies** – The government should seek to improve the marketing efficiency of food products by reducing the role of middlemen in the food chain. In line with this, the government should expand the “pasar tani” concept as well as the role of FAMA so that producers are able to directly market their product to the consumers. By doing so, FOMCA trusts that prices of food products will reduce tremendously. In the effort of increasing the productivity of the agricultural sector, the government should provide continuous support to small farmers to

pool their resources together by farming collectively in easing the burden of their production costs. FOMCA believes that by doing so, the farmers have a lot to gain, as they are able to increase their productivity and also sustain our national food production.